Bulletin

Audit and Assurance

Financial Reporting Council

October 2017

Feedback Statement and Impact Assessment

Discussion Paper: Invitation to Comment - Auditors and Preliminary Announcements

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting responsible for promoting transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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FEEDBACK STATEMENT AND IMPACT ASSESSMENT

Discussion Paper: *Invitation to comment: Auditors and Preliminary Announcements*.

Introduction

1. Current FRC guidance for auditors who are engaged to agree to the publication of preliminary results under UK Listing Authority rules is contained in Bulletin 2008/2. Bulletins have the status of 'guidance' rather than standards, and are therefore 'persuasive rather than prescriptive' and are 'indicative of good practice'. Bulletins do not deal with the application of auditing standards to specific sectors or types of transaction, but are designed to provide 'timely guidance on new or emerging issues'.

2. Bulletin 2008/2 was last revised in 2008. Following some initial stakeholder outreach we issued a discussion paper in April 2017 which considered various options for bringing the material up to date. These included converting the guidance to an engagement standard, consulting with the UK Listings Authority to require auditors to follow FRC guidance and mandating that statutory financial statement audits should be complete before auditors agree to the release of preliminary announcements. A number of other more detailed options were also presented, including proposals to revise the guidance on materiality, the review of 'other information' and of alternative performance measures. This feedback statement sets out the outcome of our consultation.

3. The FRC's Corporate Reporting team has also been conducting investor outreach on preliminary announcements, including the role of the auditor. In reaching conclusions about the way forward we have therefore also considered the emerging findings from that work.

Responses to the Consultation

4. We received **14** written responses from **7 audit firms**, **2 professional bodies**, **3** groups representing **issuers of preliminary announcements**, and **2 investors**. Further outreach carried out by the FRC Corporate Reporting team consisted of a survey and interviews with investor representatives including fund managers, private investors, investment company executives, fixed income analysts, and credit ratings agencies.

Executive Summary

5. The majority of those who responded stated that they believe the current regime for preliminaries is fit for purpose and does not require significant change. Many also commented that the role of auditors should be considered in the context of the primary role of company Directors in producing accurate and reliable financial information. This is consistent with the feedback we have received in our separate investor outreach exercise. There was also general acknowledgment that Bulletin 2008/2 should be revised, even if only to update references and reflect changes in financial reporting and listing rules.

6. One professional body (ICAS) argued in favour of a broader overhaul of corporate financial reporting, of which preliminary announcements are only one part. This is beyond the scope of this current project.

7. As a result **we are proposing only minor changes to our current auditor guidance**, and will consult with the FCA/Listing Authority on specific matters where these are within their scope as the regulator:

    - We are **not proposing** to convert the current guidance into an engagement standard;

    - We **do not propose** to require auditors to have completed the statutory financial statement audit and sign the auditor's report before agreeing to the publication of preliminary announcements – although we will continue to highlight the fact that this is best practice and consistent with most current market practice;

    - **We will include a draft report in the revised bulletin** setting out the status of the financial statement audit, and the procedures performed by the auditor on the preliminary announcement to be prepared and published on a voluntary basis; and

    - **We will coordinate with colleagues in our Corporate Reporting Team** as they conclude their work on the format and structure of preliminary announcements in combination with the UK Listing Authority. This is particularly relevant to Option 7 in our consultation and any new requirement for auditors to make an assessment as to whether the preliminary announcement is 'Fair, Balanced and Understandable'.

Option 1 – Converting the current Bulletin 2008/2 into an engagement standard

8. 7 of the specific responses to this question came from audit practitioners, and 1 from a professional body. Overall, 2 respondents supported this option, 2 disagreed with it and 4 were broadly neutral. The arguments presented in favour of converting the current Bulletin into an engagement standard were that this would make the material 'definitive' and would therefore help ensure consistent practice amongst auditors. However, those who disagreed with the proposal and the majority who were neutral felt that the current Bulletin is already treated as if it has the status of an engagement standard and that this should not be a 'priority' for the FRC.

9. Converting the current Bulletin 2008/2 into an engagement standard would have limited impact unless the FCA/UK Listing Authority introduce a requirement for auditors to follow FRC requirements when agreeing to the publication of preliminary announcements (Option 2). Current arrangements do not require companies to include any statement or report by the auditor in their preliminaries. This means that there is no transparency about whether auditors have followed the guidance in Bulletin 2008/2.

10. If the FCA/Listing Authority were to introduce a requirement of this kind then the advantage of an engagement standard over guidance would be to clearly establish the auditor's responsibilities in respect of preliminary announcements, including mandatory requirements. This would serve to formalise current voluntary practice – which is to treat Bulletin 2008/2 as if it were already an engagement standard. If the FCA/Listings Authority does not introduce a requirement for auditors to follow FRC requirements then an engagement standard would effectively have the same status as guidance – available for auditors to follow on a voluntary rather than a mandatory basis. There is therefore a clear link between Options 1 & 2 and they cannot be considered entirely in isolation from each other.

11. The wider context of our consultation and other investor outreach suggests that there are no significant concerns about the current arrangements and requirements in respect of preliminary announcements. We believe there would be advantages to converting Bulletin 2008/2 into an engagement standard as a means of providing definitive material setting out the auditor's responsibilities. However, the fact that market participants seem broadly content with the status quo suggests that there is currently no pressing need for us to issue an engagement standard. We further note that respondents to our consultation have not – in general – identified areas where the current Bulletin fails to provide sufficient guidance.

Option 2 – Consulting with other regulators establish a formal requirement that auditors follow FRC guidance when agreeing to the publication of preliminary announcements.

12. 8 respondents commented on this specific point, with 1 supporting the option, 1 disagreeing and the remainder neutral. No investors or preparers made observations on this option. Arguments in favour included ensuring consistent procedures supporting the publication of high quality and reliable financial information. Arguments against were that a non-mandatory regime allows for flexibility and pragmatism that are beneficial to all participants. Those who were more neutral made a number of specific points – including the need to consider issues relating to non-UK entities, auditors and regulators.

13. Feedback to our consultation indicates that audit practitioners "generally" make use of Bulletin 2008/2 when performing these engagements. This supports the view that they find it valuable, and that it contributes to the publication of high quality information. We therefore see a potential benefit to a formal requirement being established by the FCA/\Listing Authority for auditors to follow our guidance, or any potential engagement standard. This would formalise current arrangements, and would be consistent with the regime for Client Assets. We believe that this could be a more transparent procedure for investors, since it would clearly establish the expectation that auditors are working against a consistent set of guidance or engagement standards. However, this is a decision which can only be taken by the UK Listing Authority, with whom we will consult.

Option 3 – Extend the scope of the FRC guidance to include voluntary engagements where companies outside of the main UK listed market ask their auditors to agree the release of preliminary announcements

14. There was broad agreement from our respondents that FRC guidance should be relevant to the auditors of all listed entities who issue preliminary announcements. Many commented that it was already current practice for auditors of AIM companies, for example, to follow the guidance. Since we are not proposing to introduce any new element of mandation, then we believe it would be straightforward to revise the content of the Bulletin to ensure it is relevant to all listed entities.

Option 4 - Require audits to be complete and the auditor's report on the underpinning statutory financial statements to be signed before preliminary results can be released

15. Responses to this option varied according to source. 5 out of 7 audit firms were against any such requirement being introduced, arguing that any benefits would not be proportionate to the risks to the reporting timetable. 2 of the firms offered only conditional support – provided that it was based on clear investor demand, and that it applies consistently to all listed entities. Other respondents also questioned what the practical implications might be, including for smaller companies with fewer financial reporting

resources. Both of the investor representatives, by contrast, were in favour of this requirement because of the certainty it would provide over the status of the statutory financial statement audit.

16. The investor representatives argued that being able to issue preliminaries based on audited information is further evidence of good financial reporting discipline by companies. Our additional investor outreach found a majority of investors being in favour of having more information about the status of the financial statement audit at the time of preliminary announcements, but an overriding concern with ensuring there is no impact on the timetable for issuing preliminaries as a consequence of changes to audit arrangements.

17. Our initial research suggested that a significant majority of companies who publish preliminaries do so using audited information. There is a clear preference by investors for the financial statement audit to have been completed first, and also for some information to be included with the preliminary on the status of the audit. These factors would support a change in the current guidance to a mechanism which requires auditors to complete the audit and sign the auditor's report before agreeing to the publication of a preliminary announcement. However, we also note the overriding concern amongst investors to maintain the current reporting timetable, and the broader messages from the overall feedback that market participants believe there are no fundamental problems with current arrangements. Whilst there is evidence of some ambiguity or uncertainty about the role of the auditor, this does not seem to be source of significant concerns by investors.

18. We therefore do not propose to amend our guidance to introduce a requirement for financial statement audits to be complete before auditors agree to the publication of preliminaries. However, the guidance will continue to stress that the FRC believes this to be best practice. We consider the need for enhanced auditor reporting under option 5 below.

Option 5 – An auditor's report could be included with preliminary announcements. These reports should confirm the auditor's agreement, describe the extent and scope of their work, and/or set out key information derived from the auditor's report on the statutory financial statements

19. The majority of respondents who commented on this option did not support the introduction of a mandatory 'extended auditor's report' for preliminary announcements, including investor representatives. The reasons for this included the risk that the inclusion of a form of assurance report in connection with preliminary announcements might be misleading; potential legal complications in connection with companies act requirements; and the investor view that they would not be 'additive' in terms of value. This is consistent with the majority of the feedback from our wider investor outreach. We note that one audit firm is already offering a 'risk' or Key Audit Matter report for clients to voluntarily include in their preliminary announcements, where those are based on audited information. We therefore conclude that any demand for this information can be addressed through the operation of the market, rather than through any additional regulation.

20. However, we note that investors in particular are in favour of greater clarity about the status of the financial statement audit, and of the procedures carried out in connection with preliminary announcements. We therefore propose to amend our guidance to include a draft report which sets out clearly the status of the statutory financial statements, and the procedures which the auditor has carried out to agree the publication of the preliminary

announcement. The preparation and/or publication of this report would be voluntary since we are not proposing to issue an engagement standard to replace the current Bulletin.

Option 6 – The definition of preliminary announcement in auditor guidance should be revisited, potentially changing the scope of any procedures required for an auditor to agree to publication

21. All but one of the respondents disagreed that there is a need for auditor guidance to be revised to change the definition of the preliminary announcement and therefore the scope of the auditors' responsibilities. One of the audit firms argued that there might be an argument in favour if it was value-adding from the perspective of investors. However, none of our investor respondents identified this as an issue they want addressed.

22. We do not therefore propose to change the definition of a preliminary announcement or of the scope of the engagement as part of our current revision of Bulletin 2008/2.

Option 7 – Auditors could be encouraged or required to make an assessment of whether the material included within the preliminary statements is 'Fair, Balanced and Understandable, mirroring UK Corporate Governance Code Requirements in the respect of the annual report

23. The great majority of respondents to our consultation were opposed to the introduction of an assessment of the material within preliminary announcements as being 'Fair, Balanced and Understandable'. This was, in part, in recognition that it would be difficult for any such assessment to be made in the absence of more explicit requirements being placed on company Directors by the FCA/Listings Authority. We do note however that the investor representative who commented on this proposal was in favour.

24. We will therefore make a final assessment of the viability of this Option when our wider investor outreach is compete and our Corporate Reporting team, in liaison with the FCA/Listing Authority, have finalised any relevant proposals.

Option 8 – The guidance should be revised to include specific material on the application of materiality

25. There was general agreement that there is no need to modify or expand the guidance on materiality. The expectation is that auditors will continue to use the same materiality as for the audit of the statutory financial statements when agreeing to the publication of preliminaries, and that they have the requisite knowledge and expertise to apply an appropriate benchmark.

26. We therefore do not propose to make any significant changes to the extant guidance dealing with materiality.

Option 9 – auditor guidance should be revised to provide greater clarity about the auditor's responsibilities in respect of 'other information', and more closely aligned to the approach adopted in ISA (UK) 720. Auditors should also be required to have completed their review of 'other information' in the annual report before agreeing to the publication of a preliminary announcement

27. There are two aspects to this Option: whether FRC guidance should require that auditors should have completed their review of 'other information' before agreeing to the publication of preliminary announcements; and whether the current guidance should be more closely aligned to the approach to 'other information' in ISA (UK) 720.

28. In respect of the first of these issues many respondents argued that this was effectively the same as requiring audits to be complete and the auditor's report signed before preliminary announcements could be agreed. As a result, feedback divided between those who were in favour of Option 4 already and those who were opposed to it. Paragraph 21 of Bulletin 2008/2 describes those aspects of the statutory financial statement audit which need not be complete for auditors to still consider it to be at an "advanced stage". This includes clearing outstanding matters which the auditor judges to be immaterial; completing work on immaterial note disclosures; completing procedures in respect of 'other information'; updating the 'subsequent events review'; and receiving the final Management Representations.

29. Our wider investor outreach activity suggests that many investors are aware of the potential risks in evaluating the 'other information' included within the preliminary announcement with representative responses to our feedback survey stating:

    'It is mostly the figures which matter in prelims - the commentary is ambiguous spin which leads to potentially different interpretations.'

    'The management commentary in preliminary reporting is getting more honest and more focused'

30. On balance, we do not believe the response to our consultation would justify this change to our guidance, although we will reiterate our view that it is best practice for the audit to be complete and the auditor's report to be signed before auditors agree to the publication of preliminary announcements. We will also revise the material dealing with 'other information' in line with recent changes to ISA (UK) 720.

Option 10 – the material in the guidance which deals with Alternative Performance Measures could be revised to reflect developments in corporate reporting and related guidelines since 2008

31. The majority of the respondents to our consultation said that Alternative Performance Measures (APMs) are an area of potential concern to investors, including when used in preliminary announcements. However, there was no overall consensus on actions the FRC could take to help address those concerns. Many were supportive of Option 10 and a revision of Bulletin 2008/2 to reflect wider developments, including new guidelines on APMs issued by the European Securities and Markets Authority (ESMA). However, some also suggested that the FRC should consider a standalone Bulletin covering APMs; others stressed the need for further guidance for Directors responsible for the preparation of this information; and still others said an engagement standard rather than guidance would be appropriate.

32. In response to the feedback on Option 1 we have concluded, on balance, that it would not currently be appropriate to convert Bulletin 2008/2 into an engagement standard. We also recognise concerns expressed in our consultation relating to the use of APMs and will therefore revise our guidance to reflect developments since 2007, including the ESMA

guidelines to the extent that they are relevant to the auditor's work on preliminary announcements.

Impact Assessment

We have undertaken an impact assessment to identify any costs and benefits relating to our proposals to revise Bulletin 2008/2.

We have proposed minor revisions to update the material in the Bulletin, including the inclusion of a new voluntary 'auditor's responsibilities statement'. We do not believe that this will impact on the work effort required, or result in significant additional costs or add to the regulatory burden on business. Any necessary minor changes to audit firms' methodology and training packages will be picked up as part of their annual updates.

We do not, therefore, consider that there are measureable costs and benefits to report that arise as a result of any regulatory decisions taken by the FRC. In finalising changes proposed in the consultation, and in the light of feedback provided, we have revisited the impact assessment, but consider that no changes to it are required.

Financial Reporting Council

October 2017

Respondents to the Consultation

Crowe Clark Whitehill
Deloitte LLP
Ernst & Young LLP
GC100 Group
Grant Thornton LLP
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)
Invesco Asset Management Ltd
KPMG LLP
PricewaterhouseCoopers LLP
Quoted Companies Alliance
RSM LLP
Schroders
The 100 Group

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